

**TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING # 98-14**

WARNING

Revenue rulings are not binding on the Department. This presentation of the ruling in a redacted form is information only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Departmental policy.

SUBJECT

Application of sales and use tax to reimbursed expenses related to the sale of custom programming services and computer consulting services.

SCOPE

Revenue rulings are statements regarding the substantive application of law and statements of procedure that affect the rights and duties of taxpayers and other members of the public. Revenue rulings are advisory in nature and are not binding on the Department.

FACTS

[THE TAXPAYER] is in the business of developing and selling computer software as well as the performance of computer consulting services such as training. As standard procedure, the sales contract between the taxpayer and its customer addresses the issue of reimbursed expenses. Reimbursed expenses arise when the taxpayer's employees incur costs during the performance of custom programming services, such as modification of existing software or creation of new applications, and during the performance of consulting services. These expenses include a variety of travel and living expenses such as meals, hotel rooms, laundry, car rental, parking, etc. They do not include items passed on to the customer. In the contract, the taxpayer explicitly states that such costs should be borne by the customer. The reimbursed costs are not marked up and are separately stated on the invoice. Tennessee sales tax is paid on all taxable items at the time of purchase by the taxpayer's employees.

QUESTIONS

1. Are the reimbursed expenses described above subject to Tennessee sales and use tax?

2. If the taxpayer paid sales tax on the expense items at the time of purchase, or if the expense items were exempt from sales tax at the time of purchase, does Tennessee sales and use tax apply to these items even though the taxpayer does not charge more than the cost incurred?

RULINGS

1. The reimbursed expenses are subject to tax if they are part of a taxable sale. Custom programming services, and thus any reimbursed expenses incurred in the performance of custom programming services, are clearly subject to sales and use tax. Computer consulting services, and thus any reimbursed expenses incurred in the performance of computer consulting services, are subject to tax if performed as part of the sale of tangible personal property, including the sale of computer software or custom programming.

2. Sales and use tax applies to reimbursed expenses as stated in Answer 1. Whether the taxpayer uses only the amount of expense incurred or a different amount in determining the sales price does not change the tax consequences.

ANALYSIS

Retail sales in Tennessee are subject to sales and use tax under T.C.A. §67-6-101 et. seq. T.C.A. §67-6-102(23)(A) defines a retail sale to include a “taxable sale of tangible personal property or specifically taxable services to a consumer or to any person for any purpose other than resale.” Also subject to tax are “any services that are a part of the sale of tangible personal property....” T.C.A. §67-6-102(25).

Under the facts provided, the taxpayer sells programming and consulting services to customers located in Tennessee. At issue is whether expenses such as meals, hotel rooms, etc., which arise when the taxpayer’s employees perform these services, and which are charged to the customer as reimbursable expenses, are subject to sales and use tax.

Whether the reimbursed expenses are taxable depends solely on whether they were incurred in relation to a taxable sale. If tax applies to the sale of programming or consulting services, then tax applies to the related reimbursed expenses as well.

When a taxable sale is made, tax is imposed upon the “sales price.” T.C.A. §67-6-202. “Sales price” is defined as:

...the total amount for which a taxable service or tangible personal property is sold, including any services that are a part of the sale of tangible personal property, valued in money, whether paid in money or otherwise, and includes any amount for which credit is

given to the purchaser by the seller, without any deduction therefrom on account of the cost of the property sold, the cost of materials used, labor or service costs, losses, or any other expense whatsoever; provided, that cash discounts allowed and taken on sales shall not be included; provided, that "sales price" does not include any additional consideration given by the purchaser for the privilege of making deferred payments, regardless of whether such additional consideration shall be known as interest, time price differential on conditional sales contracts, carrying charges or any other name by which it shall be known; and provided further, that "sales price" does not include any federal retail excise tax imposed by §§ 4051-4053 of the Internal Revenue Code of 1954, as amended, or as such tax may be amended hereafter.

T.C.A. §67-6-102(25).

As can be seen from the statute above, the total amount charged, with some specific exceptions which are stated in the statute, is the proper base for the application of sales and use tax. Reimbursed expenses, even if separately stated on the invoice, do not fall within the stated exceptions. They are part of the total amount charged by the taxpayer and consequently must be included in the tax base. Furthermore, the cost of the expenses incurred by the taxpayer, and how much of that cost the taxpayer decides to pass on to its customer, is not relevant in determining the taxable amount.

The taxpayer provides custom programming services such as modification of existing software and creation of new applications. The sale of customized or packaged computer software, as well as the modification of existing software, is clearly subject to sales and use tax. T.C.A. §67-6-102(24)(B); *Creasy Systems Consultants, Inc. v. Olsen*, 716 S.W.2d 35 (Tenn. 1986). Thus reimbursed expenses incurred in making these sales are subject to tax.

The taxpayer also provides computer consulting services. Consulting services are not specifically listed as a taxable service under T.C.A. §67-6-102(23)(F). Nonetheless, they can become subject to tax if performed as part of the sale of tangible personal property, including the sale of computer software or custom programming. See, *Thomas Nelson, Inc. v. Olsen*, 723 S.W.2d 621 (Tenn. 1987). Thus, whether consulting services are taxable necessarily depends on the facts surrounding the transaction. If the sale of consulting services is subject to tax, then reimbursed expenses incurred in making the sale will be subject to tax as well.

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APPROVED: Ruth E. Johnson, Commissioner

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